audit report
OFFICE OF INSPECTOR GENERAL

Issue Date	August 13, 1996
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TO: Sidney B. Severe, Office of Housing, Pennsylvania State Office, 3AH

FROM: Edward F. Momorella, District Inspector General for Audit, Mid-Atlantic, 3AGA

SUBJECT: Herring Manor
Multifamily Project Operations
Wilmington, Delaware

We performed an audit of Herring Manor (project) to determine whether Union Baptist Community Housing Corporation (Owner) complied with the terms of the Regulatory Agreement and other applicable HUD requirements.

The report contains three findings. Ineligible and unsupported costs total $44,638 and $29,311, respectively, restricted reserve funds were used without HUD approval and the method for allocating payroll costs is inadequate.

Within 60 days please give us, for each recommendation made in the report, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is considered unnecessary. Also, please furnish us copies of any correspondence or directives issued because of the audit.

A copy of this report has been provided to the Owner and to the current Management Agent.

Should you or your staff have any questions, please contact Richard J. DeCarlo, Assistant District Inspector General for Audit, at (215) 656-3401.

Executive Summary

We performed an audit of Herring Manor (project) to determine whether Union Baptist Community Housing Corporation (Owner) complied with the terms of the Regulatory Agreement and other applicable HUD requirements. The specific audit objectives were to: (1) determine whether the Owner acquired, protected and used project resources economically and efficiently; (2) evaluate the general physical condition and maintenance of the project; (3) ensure tenants participating in HUD's Section 8 subsidy program were eligible and assistance payments made on their behalf were proper; and (4) evaluate the current Management Agent's concerns regarding the former Agent's disbursement of project funds.

The audit disclosed that a former project employee, the son of the Owner's Executive Director/Chairman, embezzled $7,937 in Federal funds between October 31, 1991 and June 30, 1992, by depositing nine payroll tax checks into his personal bank account, thereby diverting the $7,937 for his own use.

On January 10, 1996, the former employee was sentenced to one year probation, six months house arrest, and five hours community service for embezzlement of Federal funds, in violation of 18 U.S.C., Section 666 (a)(1)(A). However, he was not required to make restitution due to his current financial condition. Since the successful prosecution by the U.S. Attorney concluded this matter, an audit finding was not warranted.

The report contains three findings describing noncompliance with the Regulatory Agreement and prescribed procedures, as follows:

Operating funds disbursed for ineligible and unsupported costs

- The former Management Agent disbursed project operating funds for ineligible and unsupported costs totaling $39,038 and $20,763, respectively, because the Owner did not adequately monitor project operations. As a result, there is no assurance project funds were expended for reasonably necessary or project-related costs, as required by the Regulatory Agreement.

Restricted reserve funds disbursed without HUD approval, for ineligible and unsupported costs

- The Owner did not obtain HUD approval for disbursements from restricted reserve funds, as required, and allowed the former Management Agent to disburse reserve funds for costs that were not properly supported, or project-related. Ineligible and unsupported costs totaled $5,600 and $8,548 respectively. Ineligible costs included payment of a neighboring project's delinquent water bill. Unsupported costs included payments for delinquent utility bills and other miscellaneous items. As a result, funds may not be available to pay for extraordinary repairs and capital expenditures.

Method for allocating payroll costs is inadequate

- The current Management Agent did not have an acceptable or auditable system for allocating project payroll and fringe benefits to the project. Allocations are made based on the best judgement of the Management Agent and are not supported by time distribution records. The Owner's reliance on the Management Agent's judgement appears to have resulted in overcharges to the project. For example, 100 percent of the resident manager's salary was charged to the project, although this manager also performs day-to-day services for a neighboring project. As a result, there is no assurance that the project is being charged an equitable share of payroll costs.

During the audit, the Management Agent began to address certain deficiencies, such as developing an employee log sheet which requires employees to record the date, number of hours worked, and type of work performed, to be used as the basis for distributing payroll costs.

Recommendations

We recommended that you require the Owner to:

- Reimburse the project accounts $44,638 for the ineligible disbursements paid from project funds.

- Provide documentation supporting the propriety of expenditures totaling $29,311, and reimburse the project accounts for all payments which are not supported.

- Implement procedures to ensure restricted reserve funds are disbursed only for items specifically approved by HUD.

- Assure the recently developed employee log sheets are used as the basis for distributing payroll costs to the project.

Auditee Comments

The findings were discussed with the Owner and the current Management Agent during the audit and at an exit conference held on June 26, 1996. The Owner provided a written response on June 18, 1996 (Appendix B). Both parties agreed to cooperate with HUD in resolving the findings. The Owner's and Management Agent's comments were considered in finalizing this report.

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Abbreviations

HUD	U.S. Department of Housing and Urban Development
OIG	Office of Inspector General

Introduction

Herring Manor, project no. 032-EH-008, is a 41-unit Section 202 apartment complex located in Wilmington, Delaware. The project is owned by a nonprofit organization, Union Baptist Community Housing Corporation. Our principal contact during the audit was Reverend Otis Herring, the Executive Director/Chairman. The Vice-Chairman, Ardelia Pritchett, is currently serving as Acting Chairman.

The former Management Agent, OMNI Real Estate Corporation, managed Herring Manor from April, 1991 through September, 1993. In October, 1993, the Owner changed Management Agents and received only $1,430 (excluding the security deposit account) in project funds from the former Management Agent. The former Agent also did not provide records substantiating over $100,000 in disbursements from project accounts. In February, 1994, the new Management Agent, Capital Management Co., requested an investigation to account for the use of project funds by the former Management Agent.

Accounting records for our audit period were maintained by the two Management Agents at 3600 Silverside Road (OMNI) and 300 Cornell Drive, Suite A-5 (Capital) in Wilmington, Delaware.

Audit Objectives

The overall objective of the audit was to determine whether the project complied with the terms of the Regulatory Agreement and other applicable HUD requirements. The specific audit objectives were to: (1) determine whether the Owner acquired, protected and used project resources economically and efficiently; (2) evaluate the general physical condition and maintenance of the project; (3) ensure tenants participating in HUD's Section 8 subsidy program were eligible and assistance payments made on their behalf were proper; and (4) evaluate the current Management Agent's concerns regarding the former Agent's disbursement of project funds.

Audit Methodology

We interviewed responsible HUD Philadelphia Office staff and reviewed applicable HUD files. We also interviewed the Owner and the former and current Management Agents, and examined the project's books and records, including monthly accounting reports, rental records, bank statements, canceled checks and invoices, as well as copies of canceled checks obtained from the bank when the original canceled checks were unavailable. In addition, we examined five tenant files relating to Section 8 eligibility, and inspected five units and the common areas.

Audit Scope

Audit work was performed between May, 1994 and March, 1995 and covered the period April 1, 1991 through April 30, 1994. The audit period was extended as appropriate. The U.S. Attorney's investigation into the embezzlement of Federal funds by the former project employee, detailed in the Executive Summary, required that issuance of this report be delayed until the prosecution was concluded.

We conducted the audit in accordance with generally accepted government auditing standards.

Ineligible and Unsupported Costs Were Paid from Project Operating Funds

The former Management Agent disbursed project operating funds for ineligible and unsupported costs totaling $39,038 and $20,763 respectively. This occurred because the Owner did not adequately monitor agent operations. As a result, there is no assurance project funds were expended for reasonably necessary or project- related costs, as required by the Regulatory Agreement.

Ineligible costs included payroll costs, Christmas bonuses, and other miscellaneous expenses. Unsupported costs included payments to a company affiliated with a Management Agent employee and other miscellaneous items.

A detailed listing of the ineligible and unsupported costs was provided to the current Management Agent and the Owner's Vice-Chairman/Acting Chairman.

The former Management Agent paid $39,038 from project operating funds for ineligible costs, which included the following:

Salary for Director's Son

During 1991 and 1992, the Agent charged $31,113 of the Executive Director's/Chairman's son's salary to project operations as front-line duties. The Agent's staff indicated the Director's son was hired as the manager of a neighboring project, also owned by Union Baptist, with the intent of his becoming the manager of Herring Manor. However, this never occurred because the project has employed the same resident manager since 1989 to perform front line duties (day-to-day operations). The Director's son stated, for HUD purposes, that he could have been characterized as a project manager for the neighboring project, since Herring Manor had an on-site manager.

Supervisory Staff Salaries

The former Agent incorrectly charged it's supervisory staff salary costs to the project. Specifically, during calendar years 1992 and 1993, the Agent charged $6,500 in salaries for its office and property management division managers. The office manager stated she did not perform services for the project on a regular basis, and the property management division manager stated he supervised the maintenance and inspection of the sprinkler system, obtained bids for insurance contract, etc. Moreover, the project has a resident (site) manager to handle day-to-day project operations, whereas these two managers are the Agent's supervisory personnel responsible for monitoring project operations.

HUD Handbook 4381.5 REV-1, paragraph 2-14.B. states that supervisory personnel are paid from the management fee, whether or not they perform supervisory or front-line tasks. (emphasis added)

Other Ineligible Costs

Other ineligible costs of $1,425 included $900 disbursed in 1992 for Christmas bonuses and $525 for services provided at the neighboring project and at the church at which the Executive Director is pastor.

The Regulatory Agreement, Section 11(c) states neither the mortgagor or its agents shall make any payment for services, supplies, or materials unless such services are actually rendered for the project or such supplies or materials are delivered to the project and are reasonably necessary for its operation.

In addition, the former Agent made unsupported payments totaling $20,763 from the project's operating funds. The agent's supporting documents included only canceled check and check vouchers.

Identity-Of-Interest Payments

During the period 1991 to 1993, $9,401 of project funds were disbursed to a company affiliated with the former Management Agent's Office Manager for grounds maintenance, repairs, decorating contracts and painting services. However, the documentation provided did not substantiate that the services were provided at the project.

Other Unsupported Costs

Other unsupported disbursements consisted of $2,957 made to the nonprofit owner organization, $1,000 to a maintenance employee, and Miscellaneous disbursements of $7,405.

HUD Handbook 4370.2 REV-1 paragraph 2-6.B. states that all disbursements from the regular operating account (including checks, wire transfers and computer generated disbursements) must be supported by approved invoices/bills or other supporting documentation.

Auditee Comments

The current Management Agent and the Vice-Chairman/Acting Chairman agreed to cooperate with HUD in resolving the findings, and indicated that they will attempt to recover the ineligible and unsupported disbursements made by the former Management Agent, as well as obtain certain vendor invoices.

Recommendations

We recommend that you require the Owner to:

1A. Reimburse the project account $39,038 for the ineligible disbursements paid from operating funds.

2B. Provide documentation supporting the propriety of expenditures totaling $20,763, and reimburse the project account for all payments which are not supported.

Restricted Reserve Funds Were Used Without HUD Approval

The project Owner and former Management Agent did not obtain HUD approval for disbursements from restricted reserve funds, as required. Reserve funds were disbursed for ineligible costs, or for costs that were not properly supported or project-related. Ineligible and unsupported costs totaled $5,600 and $8,548, respectively. As a result, funds may not be available to pay for extraordinary repairs and capital expenditures.

HUD must approve disbursements from Reserve for Replacement

The Regulatory Agreement, Section 5 (a) states disbursements from the Reserve for Replacement fund may be made only after the consent in writing of HUD. The Regulatory Agreement Section 5 (c) states Residual Receipts shall be under the control of HUD and shall be disbursed only at the discretion of HUD for such purposes as it may determine to be necessary or appropriate.

Goods and services must be necessary for project operations

Section 11(c) states neither the mortgagor or its agents shall make any payment for services, supplies or materials unless such services are actually rendered for the project or such supplies or materials are delivered to the project and are reasonably necessary for its operation.

An analysis of the accounts noted that since fiscal year 1991, over $100,000 was withdrawn without HUD approval. The Executive Director and previous Management Agent staff indicated they were not aware HUD approval was necessary to withdraw funds from the Reserve for Replacement and Residual Receipts accounts.

Reserve for Replacement

Ineligible and unsupported costs paid from the Reserve for Replacement fund totaled $5,600 and $6,748, respectively.

Specifically, the former Management Agent disbursed $5,600 to pay a neighboring project's delinquent water bill and $6,748 in two unsupported checks ($5,912 and $836). The Executive Director stated the Board of Directors was not active in monitoring the Agent's management of the project.

Residual Receipts Fund

The former Agent disbursed $1,800 from the Residual Receipts Fund for payment of the project's 1992 audit. However, the Agent 's staff stated the 1992 audit was not completed.

Details regarding the ineligible and unsupported costs were provided to the current Management Agent and the Owner's Vice-Chairman/Acting Chairman.

Auditee Comments

The current Management Agent and the Vice-Chairman/Acting Chairman agreed to cooperate with HUD in resolving the findings, and indicated that they would attempt to recover the ineligible and unsupported disbursements made by the former Management Agent, as well as obtain certain vendor invoices.

Recommendations

We recommend that you require the Owner to:

2A. Reimburse the project $5,600 for the ineligible disbursements from the Reserve for Replacement.

2B. Provide documentation supporting the propriety of the expenditures totaling $8,548, or reimburse the appropriate reserve fund for any payments not supported.

2C. Implement procedures to ensure restricted reserve funds are disbursed only for items specifically approved by HUD.

Method for Charging Payroll Costs is Inadequate

The current Management Agent does not have an acceptable or auditable system for allocating payroll and fringe benefits to the project. Allocations are made based on the "best judgement" of the Agent and are not supported by time distribution records. As a result, there is no assurance that the project is being charged an equitable share of payroll costs.

Expenses must be reasonable and necessary and project books must be auditable

The Management Agent Certification, paragraph 4.a. states that the Agent agrees to assure that all project expenses are reasonable in amount and necessary to the operation of the project. In addition, the Regulatory Agreement, Section 11(d), requires that the project's books, contracts, records, and documents shall at all times be maintained in reasonable condition for proper audit.

The Agent did not have an acceptable system for charging the project with an equitable portion of payroll and fringe benefits. Also, the Agent did not analyze these costs through the use of employee time distribution records or provide other documentation to support the costs charged to the project.

Payroll costs distributed according to "best judgement"

The payroll costs for six employees who perform services at the project and at neighboring development owned by the mortgagor are distributed in accordance with the Management Agent's "best judgement" of the percentage of time that would be required by each employee to complete their assigned duties at each respective project.

Project was overcharged for salaries and fringe benefits

The Owner's reliance on the Management Agent's judgement, rather than requiring that actual time distribution records be prepared, appears to have resulted in overcharges to the project. Specifically, although 17 percent of employee benefits are charged to the project each year, the Agent provided no documentation to substantiate how this percentage was developed. In addition, 100 percent of the resident manager's salary and 80 percent of a grounds/janitor employee's salary were charged to the project, although this manager also handles the day-to-day operations of a neighboring project. The grounds/janitor employee also performs services at the neighboring project.

The Agent has recently developed an employee log sheet which requires the employee to record the date, the number of hours worked, and the type of work performed at each project.

Without adequate documentation to show that the project is being charged an equitable share of the payroll costs, there is no assurance that the costs allocated to the project are reasonable and necessary for project operations.

Auditee Comments

The current Management Agent stated that he had begun to implement our recommendation.

Recommendation

We recommend you require the Owner to:

3A. Assure that the recently-developed employee log sheets are used as the basis for distributing payroll costs to the project.

Internal Controls

In planning and performing our audit, we considered internal control systems of the former and current Management Agents, to determine our auditing procedures and not to provide assurance on internal controls. Internal control is the process by which an entity obtains reasonable assurance as to achievement of specified objectives. Internal control consists of interrelated components, including integrity, ethical values, competence, and the control environment which includes establishing objectives, risk assessment, information systems, control procedures, communication, managing change, and monitoring.

Control Categories

We determined the following internal control categories were relevant to our audit objectives:

- Revenues and Expenditures
- Assets and Liabilities

Scope of Work

We evaluated all of the relevant control categories identified above by determining the risk exposure and assessing control design and implementation.

Significant Weaknesses

A significant weakness exists if internal control does not give reasonable assurance that the entity's goals and objectives are met; that resource use is consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data are obtained, maintained, and fairly disclosed in reports. Based on our review, we believe the following items are significant weaknesses:

- Revenues and Expenditures (Findings 1 and 3)
- Assets and Liabilities (Finding 2)

Follow Up On Prior Audits

This was the first OIG audit of Herring Manor's operations.

Schedule of Ineligible and Unsupported Costs

Finding No.	Ineligible 1/	Unsupported 2/
1	$39,038	$20,763
2	$ 5,600	$ 8,548
	$44,638	$29,311

1/ Ineligible amounts are not allowed by law, contract, HUD or local agency polices or regulations.

2/ Unsupported amounts are not clearly eligible or ineligible but warrant being contested (e.g., lack of satisfactory documentation to support the eligibility of the costs, etc.)

Auditee Comments

Distribution

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